capping between companies illustrates the measure of control that the LECs have over their OPEB costs. Where this ability to control exists, a limitation on the SFAS 106 accrual amount given exogenous treatment is appropriate to avoid a windfall for LECs who have not implemented capping as a cost-control measure or who have implemented or plan to implement only limited caps on their benefit plans.

Second, limiting the LECs' SFAS 106 accruals for purposes of exogenous treatment is appropriate because OPEB accruals are necessarily highly speculative and can vary significantly based on a LEC's assumptions. As NYNEX (p. 11) admits,

> "By its very nature, identifying OPEB costs entails projections of future costs which rely on assumptions about employee force levels, service periods, retirement periods, benefit amounts, inflation, return on plan assets, etc."

The data filed by NYNEX illustrate how a change in a single assumption can have a dramatic influence on the size of the OPEB accrual. NYNEX (p. 12) indicates that its estimated incremental interstate SFAS 106 accrual amount varies anywhere from $45 to $101 million annually, depending on whether it projects postretirement medical benefits for non-management employees at the full medical trend rate or caps the company's benefit payment for this group at the estimated 1995 level. Based on information from the LECs' direct cases, total company OPEB costs per employee also show a tremendous variation in range: from a low of $1660 for BellSouth to a high of $4658 for SWBT.* Indeed, many of the variables in the SFAS 106 accrual are inherently difficult to predict, including the levels of future health care inflation and interest rates, the degree of benefit capping that will be instituted, or how the firm will manage the plan in terms of deductibles or annual fees.**

In an attempt to test the impact of changes in certain LEC assumptions on the SFAS 106 accrual, AT&T engaged an independent firm of actuarial consultants to develop a model of Pacific's SFAS 106 accrual.*** The model showed that the SFAS 106 accrual is highly sensitive to changes in assumptions. For example, if the health

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* As explained in Appendix E, AT&T derived these figures by dividing (i) each price cap LEC's total company OPEB costs as filed in its direct case by (ii) the company's total number of active and retired employees as shown on its 1991 Form M (the latest employee count available).

** Duff & Phelps confirm this, observing that

> "Actuarial studies and various assumptions regarding employee characteristics and the future status of health care policies vary greatly. These differences will make it difficult to analyze this liability . . . ."

William A. Abrams & Mary Beth McGirr, <u>SFAS 106 and its Impact on Utility Credit Quality</u>, Vol. 9, Credit Decisions (Duff & Phelps, Inc., March 23, 1992), p. 6 ("Credit Decisions") (article appended to Bell Atlantic's Direct Case as Attachment A.)

*** The Actuaries' Sensitivity Analysis is contained in Appendix F hereto.

care trend parameter is reduced 1 percentage point from the value assumed by Pacific, the accrual is reduced 15.3%. If the health care trend is reduced 4 percentage points (approximately the projected value for changes in GNP-PI), the accrual is reduced 45%.* Because the SFAS 106 accrual level is very sensitive to small changes in any of the assumptions, it is necessarily somewhat speculative and has a wide margin of variability.**

The difficulty of making an accurate cost assessment was one of the key factors relied on by the Commission in refusing to grant exogenous treatment to equal access costs.*** Similarly here, the actual OPEB expense that a carrier is likely to incur is unlikely to be forecasted with a high degree of accuracy because of the myriad of assumptions that must be made.

Third, the Commission has previously cautioned against price cap rates that are "'too high' in an

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* <u>See</u> Appendix F, p. 11.

** A further analysis performed by AT&T showed that several companies (Ameritech, BellSouth, NYNEX (utilizing its low-end estimate), and SNET) are incurring a high percentage of their overall projected SFAS 106 expense currently through cash pay-as-you-go expenses (<u>see</u> Appendix G). This tends to show that their OPEB assumptions are closely related to actual experience and, conversely, that the other LECs' assumptions above pay-as-you-go levels may be due to generous plan assumptions (<u>e.g.</u>, limited or no capping, inclusion of substantive plan commitments, assumptions chosen in actuarial models).

*** <u>LEC Price Cap Order</u>, 5 FCC Rcd. at 6808 (¶ 180).

economic sense."* Inflated price cap rates would give the LECs the "added ability to achieve a productivity target without actually achieving true productivity gains."**

Because of the measure of control that LECs have over their actual OPEB expense levels, the necessarily speculative nature of their current SFAS 106 OPEB accruals, and the "obvious and strong incentives" that carriers have to inflate their price cap rates exogenously,*** there is a substantial risk that if the LECs get full exogenous treatment, their rates would be uneconomically high as compared to their actual OPEB expense levels. This would enable a LEC to achieve an unearned windfall at the expense of consumers. For example, a LEC could decide to impose new benefit caps on its OPEB plans immediately after receiving exogenous treatment, thereby lowering its actual OPEB liability and enjoying an unwarranted increase in its rate of return. A LEC, such as Rochester, which has not factored in any medical benefit cap in its SFAS 106 accrual, would be free to introduce such a cost control measure at any time, and thereby create a major divergence between the SFAS 106

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* <u>See</u> <u>Southwestern Bell Telephone Company</u>, Memorandum Opinion and Order, FCC 92-175, released May 6, 1992, ¶ 16.

** <u>Id.</u>

*** <u>Id.</u>

accrual that it used to justify the amount of exogenous expense reflected in its PCI and its actual OPEB expense level.*

In light of these considerations, as SWBT (p. 12) correctly anticipates, some appropriate limits should be put on the amount of the OPEB accruals afforded exogenous price treatment. AT&T suggests that, for purposes of exogenous price cap treatment only, the Commission set specific parameters, described below, on the assumptions underlying capping of benefit plans, the discount rate, rate of return on plan assets, and health care trend rate (net of inflation), and then require each price cap LEC to recalculate its OPEB accruals using those assumptions and allow exogenous treatment for the resulting amount. This would result in the LECs making reasonable and conservative estimates of their OPEB liabilities for pricing purposes, consistent with the overall trend among employers to control postretirement health care costs.**

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* Or, a LEC could choose not to curtail its OPEB program (because expense recovery is assured), but it could instead limit future wage and salary increases which are treated endogenously. The Commission declined to give equal access costs exogenous treatment in part because of the risk that a LEC could willfully or inadvertently shift switched access costs (which are treated endogenously) into the equal access category for assured recovery. <u>LEC Price Cap Order</u>, 5 FCC Rcd. at 6808 (¶ 180). A LEC could make similar trade-offs between OPEB expense and salaries/wages, particularly if the level of the OPEB accrual granted exogenous treatment were overly generous.

** Credit Decisions, at 6.

AT&T suggests that the following specific parameters be employed. First, the Commission should not allow companies that have not taken steps to curb their OPEB expense levels to enjoy exogenous cost recovery at any level they choose. This is necessary to avoid both unfairness to ratepayers from region to region and a windfall for any LEC that has delayed capping benefits as a cost-control measure. AT&T recommends that the LECs be required to revise their actuarial models assuming that all companies had elected caps. At a minimum for this calculation, the companies should assume Medical Expense Plan, Medicare Part B premium reimbursements and Dental Care Plan costs per employee will be capped at the level projected as of January 1, 1993, i.e., the date the Bureau has required them to implement SFAS 106, for all employees who are active as of January 1, 1993.* If a company has already implemented some level of capping or cost containment that exceeds this minimum (whether for active or retired employees), that impact would remain as actually experienced. For calculating the impact of capping for the purpose of this price cap filing, no

* AT&T is not recommending that these caps be applied for employees who retired prior to January 1, 1993. For those employees, AT&T recommends that their health care costs be projected using the health care trend rate as specified on pp. 28-29, infra.

provisions for "substantive plan" increases in benefits should be included, because any such increases would undo to some degree the curbing action of capping.*

Second, as shown above, the cost levels reported by the LECs vary widely because of the breadth of assumptions chosen in their actuarial models. The assumptions which drive the models should also be set at equitable levels in all of the actuarial models. The Commission should accept the demographic factors that each company actually experiences, such as mortality, retirement age, separations, dependents. However, the Commission should set specific parameters for the actuarial models in terms of discount rate, rate of return on plan assets, and health care trend rate. As shown in the actuarial sensitivity analysis,** the total SFAS 106 accrual amount can be significantly affected by the levels assumed for these variables and there is actually no reason why they should vary significantly among companies.

AT&T recommends that the Commission require all LECs to utilize those company's assumptions, shown below, that minimize the total OPEB liability. Each of the

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* Under SFAS 106, an employer's cost-sharing policy or past practice of regular increases in the benefits provided (although not called for under the written benefit or "extant plan") defines what is known as the "substantive plan," <u>i.e.</u>, the benefit plan as "understood" by both parties. The effects on Pacific's SFAS 106 accrual of capping benefits for active employees, as suggested by AT&T, is shown in Appendix F, p. 12.

** <u>See</u> Appendix F, Results of Sensitivity Tests, pp. 10-13.

suggested parameters was employed by at least one of the LECs in calculating the SFAS 106 accrual in its direct case.* These parameters are:

Discount Rate**	9%
Rate of Return on Plan Assets	9%
Health Care Trend Rate (includes inflation)	10% in 1991, decreasing by 0.4% annually to 4% in 2006

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* BellSouth employed the discount rate; NYNEX used the rate of return; and Ameritech (Exhibit 9, Table 1) used the health care trend rate. The "discount rates" assumed by the LECs varied from a low of 7.5% for SWBT and Ameritech to a high of 9% for BellSouth; the assumed "rate of return on plan assets" varied from a low of 7.5% for Bell Atlantic and SWBT to a high of 9% for NYNEX. In addition, the assumed starting "health care trend rate" showed significant fluctuations among carriers, from a low of 9% for U S WEST as compared to 15% for Bell Atlantic, GTE and NYNEX.

** SFAS 106 (p. 11, ¶ 31) requires that the discount rate used to compute the accrual reflect the present value of future cash flows needed to satisfy the employer's anticipated postretirement benefit obligation. In determining the discount rate, SFAS 106 explains that employers should employ a mix of currently available fixed-income investments (e.g., long-term bonds), the cash flows of which match the timing and amount of expected benefit payments. Because it is reasonable to assume that the employee mix (age, retiree-to-active ratios, etc.) is similar for each of the LECs, it is reasonable to expect them to use the same discount rate, given that they all have access to the same investment vehicles. See Appendix F, p. 11.

Similarly, SFAS 106 (p. 12, ¶ 32) explains that, in developing the expected rate of return on plan assets, the company should use the market value of plan assets based on available investment opportunities. Because the same investment opportunities are available to all LECs, it is reasonable to expect them to use the same return figure.

(footnote continued on following page)

In recalculating the accruals using these parameters, the health care trend rate should be reduced by 4 percentage points to eliminate the double count of OPEB-related costs recoverable through GNP-PI using the approach discussed in Part I.B, supra, and the benefit costs should be capped as discussed above.*

Limiting exogenous treatment based on these criteria would: (a) provide LECs with the proper incentives to become more efficient in their management of OPEB expense, and (b) protect ratepayers from paying for accruals based on speculative assumptions as to OPEB benefit levels that may never be paid by the LEC.

(footnote continued from previous page)

SFAS 106 (p. 14, ¶ 39) states that the health care cost trend rate represents "the expected annual rate of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in demographics of plan participants, for each year from the measurement date until the end of the period in which benefits are expected to be paid." This requires companies to consider estimates of health care inflation, health care utilization or delivery patterns, and changes in the health status of plan participants in developing the expected health care trend rate. Current national health care cost trends are at approximately the 10% level (see Appendix H). Ameritech used this 10% health care trend figure in 1991 and gradually reduced it over a fifteen year period in its SFAS 106 accrual. Because the Commission has determined that use of GNP-PI (a national inflation indicator) is an appropriate benchmark for the LECs' price cap indices, AT&T believes that use of a national health care cost index, which is conservative in its assumptions, is likewise reasonable for LEC pricing purposes here. See Appendix F, pp. 11-12.

* The cumulative effects of these assumptions on Pacific's SFAS 106 accrual is shown in Appendix F, p. 13.

CONCLUSION

For the reasons stated above, the Commission should limit exogenous treatment of the price cap LECs' SFAS 106 OPEB accruals in the manner discussed above.

Respectfully submitted,

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LIST OF PARTIES FILING DIRECT CASES

Ameritech Operating Companies ("Ameritech")

Bell Atlantic

BellSouth Telecommunications, Inc. ("BellSouth")

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE")

New England Telephone and Telegraph Company and New York Telephone Company ("NYNEX")

Pacific Bell and Nevada Bell ("Pacific")

Rochester Telephone Corporation ("Rochester")

Southern New England Telephone Company ("SNET")

Southwestern Bell Telephone Company ("SWBT")

The United States Telephone Association ("USTA")

The United Telephone Companies ("United")

U S WEST Communications, Inc. ("U S WEST")

SUMMARY OF THE GODWINS STUDY

The Godwins Study employed actuarial and macroeconomic analyses to estimate the percentage of price cap LEC OPEB costs that will be recovered via changes in GNP-PI. According to Godwins (p. 1),

> "This study finds that ultimately the increase in GNP-PI caused by SFAS 106 (.0124%) will provide for recovery of 0.7% of the additional costs incurred by Price Cap LECs. Other macroeconomic factors, principally an eventual adjustment of the national wage rate, account for recovery of an additional 14.5% of the additional costs incurred by Price Cap LECs, leaving 84.8% of these additional costs unrecovered."

Godwins essentially used the following five-step method to estimate the effects of SFAS 106 on GNP-PI. (1) Godwins employs an actuarial study to determine that the average LEC (the composite "TELCO") will experience a 6.295% increase in direct labor costs as a result of adoption of SFAS 106. (2) The 6.295% increase in LEC labor costs is then "adjusted" by numerous factors, including benefit level indicator adjustments, demographic adjustments, current retiree adjustments, prefunding adjustments, per-unit labor cost adjustments, to convert it to an increase of 3% in labor costs for the average non-TELCO employer offering OPEB benefits (pp. 31, 38, 16-23). (3) Godwins then makes a "back-of-the-envelope" estimate and concludes that this 3% increase in labor costs will increase GNP-PI by .549% (p. 10). (4) A macroeconomic general equilibrium model is then used to calculate a "pass-through coefficient" of 2.3%, i.e., GNP-PI will only increase .0124% instead of the flowthrough of .549% calculated using the "back-of-the-envelope" method. The remaining 97.7% (100% - 2.3%) of the SFAS 106-related increase in labor costs that is not passed through to prices is apparently dispersed by the macroeconomic model to a substitution of capital for now more expensive labor (given that only labor generates SFAS 106 expense) and a repression of demand for the output of firms that bear SFAS 106 OPEB expense and a concomitant increase in demand for the output of firms that do not offer OPEB benefits. (5) Finally, Godwins calculates that, using the "back-of-the-envelope" methodology, the 6.295% increase in LEC direct labor costs would result in a 1.8027% increase in LEC prices, so .0124 ÷ 1.8027 or 0.7% of the LECs' SFAS 106 costs will be directly recovered through GNP-PI (p. 31).

NERA'S ANALYSIS OF THE DOUBLE COUNT RESTS ON AN INCORRECT ASSUMPTION. ONCE THAT ASSUMPTION IS CORRECTED, IT DEMONSTRATES THAT ONLY A LIMITED PORTION OF PACIFIC'S AND ROCHESTER'S OPEB ACCRUALS WOULD NOT BE RECOVERED THROUGH GNP-PI

NERA estimates the double count for Pacific Bell (and Nevada Bell) using the following approach.* The economy is separated by NERA into a regulated or cost-plus sector of the economy comprising at most 10.49% of GNP,** and a nonregulated sector comprising at least 89.51% of GNP. NERA contends that firms in the nonregulated sector adjusted their prices before price caps began for the LECs on January 1, 1991 in anticipation of the SFAS 106 requirement. Only firms in the "cost-plus" sector had not yet adjusted their prices to cover the SFAS 106 accrual when LEC price caps began. NERA concludes the economy will be impacted by a 1.1% increase in prices due to SFAS 106 implementation.*** Because nonregulated firms have

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* The NERA Study is attached as Appendix 1 to Pacific's Direct Case. Although NERA does not discuss any of its data, Rochester (p. 12) apparently relies on the NERA Study and concludes that only 4.2% of its SFAS 106 accrual would be recovered through GNP-PI.

** The regulated sector includes public utilities and firms subject to government contracts that cover only pay-as-you-go costs. NERA, p. 29.

*** NERA (pp. 31-32) itself provides a quantification of the impact of SFAS 106 on the economy:

> "U.S. OPEB expenses are estimated to be about $13 billion in 1993 on a cash accounting basis compared with about $82 billion on an accrual basis in 1993. The change is thus $69 billion out of an estimated GNP of $6,260 billion, or 1.10% . . . . [T]he incidence of OPEBs appear to be uniformly distributed across industries . . ."

already adjusted their prices, SFAS 106 would only increase prices by 0.12%* after LEC price caps began. Pacific's costs will increase 1.92% due to the adoption of SFAS 106 so, according to NERA, the double count due to a part of Pacific's costs also being reflected in future growth of GNP-PI is 0.12/1.92 or 6.26%.** In other words, NERA claims that 93.74% of Pacific's SFAS 106 accrual would qualify for exogenous treatment. NERA is wrong.

NERA's double count analysis is flawed because it rests on the empirically unsupported assumption that nonregulated profit-maximizing firms already include the present value of future OPEB costs in their pricing decisions and therefore the imposition of SFAS 106 accounting will not cause any future change in their prices.*** In NERA's view, nonregulated firms' perception of future costs coincide exactly with the methodology prescribed to calculate the SFAS 106 costs and therefore the adoption of SFAS 106 will not change the firm's future behavior.

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* (1.10 x 0.1049)+(0.0 x 0.8951)=0.12 (*See* NERA, p. 32). That is, a 1.10% increase in the "cost-plus" sector plus no price change in the nonregulated economy.

** NERA, p. 32.

*** NERA, p. 12 *et seq.* Regulated firms, according to NERA, have been prevented from pricing to recover accrued costs, and NERA anticipates that the adoption of SFAS 106 would allow these firms to increase prices.

As NERA (p. 9 _et seq._) correctly points out, firms make pricing decisions based on economic costs and not accounting costs. The FASB makes clear in its Introduction to Statement 106 that the purpose of the accounting rule change is to improve financial reporting; SFAS 106 was not designed to give firms a tool to aid in setting prices. SFAS 106 costs do not, in fact, reflect economic costs because they are based on assumptions of events too far into the future for firms to consider accurate. The SFAS 106 accrual is based on parameter values that incorporate a large degree of uncertainty, such as the levels of future medical inflation and interest rates, the degree of benefit plan capping that will be instituted, and how the firm will manage the plan in terms of deductibles or annual fees. Because of the uncertainties as to what will transpire beyond the next few calendar quarters, nonregulated firms will tend to discount information seen as tentative. SFAS 106 costs are also poor proxies for economic costs because the FASB explicitly forbids firms from considering the impact of probable, but not yet approved, legislation such as national health insurance or other government-imposed controls on medical costs. However, a well-managed firm would incorporate such important information in setting prices and not simply increase its prices by the SFAS 106 accrual.*

Therefore, a much more reasonable assumption is that nonregulated firms are constantly revising their perceptions of costs (and therefore, prices) as more accurate information becomes available over time. Firms would tend to put less emphasis on accrued costs and more on cash costs in decision making. SFAS 106 may help make information more manifest, but it does not remove the uncertainties of forecasting the future. Nonregulated firms would tend to increase prices when pay-as-you-go costs increase or when the costs can be more accurately forecasted, i.e., when the magnitude of the accrued amount becomes less speculative. In other words, prices will

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* The inappropriateness of NERA's assumptions is borne out by the LECs themselves. In their direct cases, the LECs note the difficulty in calculating the size of the OPEB accrual. Several LECs, for example, note that any predictions of the impacts of changes such as the creation of a national health insurance program, changes in Medicare, or capping are currently too speculative to be quantifiable. (See SWBT, p. 29; Rochester, p. 27; SNET, p. 12.) NYNEX (p. 11) states that calculating OPEB costs is difficult due to the projections involved and has accordingly provided a broad range of estimates. The FASB itself has noted the difficulty in constructing the amount of the accrual, stating in its Summary to SFAS 106, "The Board recognizes that limited historical data about per capita claims costs are available and that actuarial practice in this area is still developing." (December 1990).

rise slowly over time as firms integrate better information in their business planning.*

When its incorrect assumption is removed, NERA's own methodology yields much greater estimates of the amount of double count. The significant conclusion from NERA's estimates is that the economy will be impacted by almost the entire 1.10% increase in prices as the economy adjusts to the OPEB liability. Because it is highly unlikely that nonregulated firms have already adjusted their prices to anticipate the SFAS 106 accrual, any exogenous treatment should net out the approximately 1.10% impact that will be embedded in <u>future</u> changes in

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* There is little evidence that nonregulated firms have taken tangible steps to meet their SFAS 106 liabilities, such as setting up VEBA trusts to match their estimated accruals. An examination of the professional and business literature shows that funding levels have been low. For example, the <u>Journal of Accounting</u>, "The Big Unfunded Liability: Postretirement Health Care Benefits" (Nov. 1988, p. 29) points out that companies tend not to prefund. A <u>Wall Street Journal</u> article, "GM is Facing a High Charge Up to $34 Billion," (Nov. 11, 1991, p. A2, cols. 1 & 2), states General Motors faces an unfunded charge of $16 to $34 billion, Ford will have a charge of $5 to $9 billion and Chrysler will have up to $6 billion. Even if nonregulated firms have increased their prices to cover their future OPEB liabilities, if they have not retained the additional revenues in a fund for payment of OPEB expenses, it is doubtful that the cash will be available when needed to pay OPEB benefits in future years. Thus, because it appears that nonregulated firms have not funded, they would be likely to raise their prices again in the future to cover their OPEB liabilities.

GNP-PI.* Using NERA's methodology, but assuming that the nonregulated sector of the economy has not increased prices in anticipation of SFAS 106 adoption, only 43% of Pacific's accrual would qualify for exogenous treatment, i.e., the excess of its OPEB liabilities over the economy-wide average, (1.92 - 1.10)/1.92 = 43%. The remaining 57% (not the 6.26% calculated by NERA) of Pacific's accrual would be recovered through the impact of GNP-PI in the PCI formula. Applying the same NERA methodology to Rochester shows that 31% of its accrual would be recovered through the GNP-PI in the PCI formula, not the 4.2% that Rochester calculates.** In short, a significant portion of Pacific's and Rochester's SFAS 106 accruals do not qualify for exogenous treatment because the costs will be recovered endogenously through changes in GNP-PI.

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* The 1.10% increase in GNP-PI will be spread over many years (e.g., 0.10% per year for eleven years) as firms adjust their prices to reflect their OPEB liabilities.

** Rochester (Exhibit III, p. 2 of 3, line 5) (including Vista) states that its incremental SFAS 106 revenue requirement is $3,251,000 before the double count is removed; and its 1991 interstate revenues were $92,320,000 (FCC Form 492 Report, Calendar Year 1991). Thus, Rochester is asking for a price increase of approximately 3.25% = ($3,251,000/$92,300,000). Using NERA's methodology, but assuming the nonregulated sector has not increased prices in anticipation of SFAS 106 adoption, shows that 31% = 1.10/3.52 of Rochester's SFAS 106 costs would be recovered via GNP-PI and 69% = (3.52 - 1.10)/3.52 would qualify for potential exogenous recovery.

WEFA FORECAST OF INFLATION*

	Annual Inflation Rate GDP-PI
1993	2.8%
1994	3.0%
1995	3.6%
1996	3.9%
1997	4.0%
1998	4.1%
1999	4.0%
2000	4.0%
2001	4.0%
2002	4.0%
2003	4.0%
2004	4.1%
2005	4.1%
2006	4.0%
2007	4.0%
2008	4.1%
2009	4.1%
2010	4.1%
Avg 1993-2010	3.9%

* Source: The WEFA Group, June 1992 U.S. Long Term Economic Outlook, Trend Scenario, Volume 1, Table 1.2.

COMPARISON OF GDP-PI AND GNP-PI FOR THE 10-YEAR PERIOD 1982-1991 AND FIRST QUARTER 1992*

	GDP-PI	GNP-PI
1982	84.8	84.9
1983	88.1	88.2
1984	91.1	91.1
1985	94.3	94.4
1986	97.0	97.0
1987	100.0	100.0
1988	103.9	103.9
1989	108.4	108.4
1990	113.1	113.1
1991	117.6	117.6
1992 (1Q)	119.6	119.6

* Source: The WEFA Group, National Income and Product Accounts Database, June 25, 1992, Series APDFGDP (Fixed-Weight Price Index, Gross Domestic Product, Annual) and Series APDFGNP (Fixed-Weight Price Index, Gross National Product, Annual). WEFA obtains these data directly from the Bureau of Economic Analysis, U.S. Department of Commerce, National Income and Products Accounts, Tables 7.1 and 7.3, respectively, on a monthly basis. The first quarter 1992 data are from The WEFA Group, June 25, 1992, Series PDFGDP, Quarterly, and Series PDFGNP, Quarterly.

TOTAL COMPANY OPEB COSTS PER EMPLOYEE

In an effort to examine the LECs' SFAS 106 accruals as filed in their direct cases, AT&T designed the following analysis to determine the total 1993 SFAS 106 cost per employee. AT&T determined this cost by taking each of the LECs' total company 1993 SFAS 106 liability, as filed in its direct case, and dividing it by the LEC's total company active and retired employees that are pension-eligible. AT&T believes that pension-eligible employees are the ones who would also be eligible for SFAS 106 OPEB benefits. The employee data (both active and retired) were obtained from the LEC's Form M for the year ended December 31, 1991. These data appear on Form M, Schedule I-4 (lines 12 and 13) for management and non-management employees. Because United and GTE have several Tier 2 companies which are not required to file Form M, the retiree employee data were not available. AT&T urges the Commission to obtain these data from United and GTE and include them as part of this analysis.

As displayed in the table below, the total OPEB costs per employee clearly show a tremendous variation in range: from a low of $1,660 for BellSouth to a high of $4,658 for Southwestern Bell. Some of the variation is because the LECs reflected the effect of the accumulated balances in their VEBA trusts (if any) to reduce their unfunded SFAS 106 obligation. The substantial contributions that BellSouth has made to its VEBA trusts significantly reduce its overall SFAS 106 obligation.* AT&T believes that because nearly all the other LECs (with the exception of Rochester and United who have no trusts) have begun to fund only a limited portion of their SFAS 106 liability, the total OPEB costs per employee do not vary significantly among companies as a result of funding.

AT&T concludes that to a large extent, the significant variation between companies in SFAS 106 costs per employee is indicative of the variety of actuarial and macroeconomic assumptions used by the LECs. Whether or not the LEC's benefit plans are capped (and, if so, at what level) will meaningfully affect a LEC's projected SFAS 106 expense. For example, U S WEST ($3,863 per employee) requires retiree contributions (for employees retiring after 12/31/90) which cover only 20% of their future medical cost increases.** In contrast, Ameritech ($2,972 per employee) has a

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* BellSouth's costs per employee reflect its historical contributions to trusts which include funded amounts for all representable employees, as well as funded amounts for management and non-representable employees retiring after May 1, 1985.

** U S WEST, Direct Case, Attachment F, Table 91-3.

more rigorous program which has a defined dollar amount that explicitly limits the amount of the employer commitment for retiree medical costs (*see* Ameritech, Direct Case, p. 21).

Total OPEB Cost Per Employee

	(1) Total Company 1993 SFAS 106 Liability ($000s)(B)	(2) Total Active and Retired Employees(A)	(3) = (1) ÷ (2) Total OPEB Expense Per Employee
Ameritech	$384,089	129,215	$2,972
Bell Atlantic	418,599(E)	121,227	3,453
BellSouth	210,000	126,470	1,660
NYNEX (low estimate)	372,342(C)	143,155	2,601
NYNEX (high estimate)	584,578(D)	143,155	4,084
Pacific Telesis	402,505	110,662	3,637
Rochester	21,509(F)	6,226	3,455
SNET	41,300	19,092	2,163
Southwestern Bell	426,502	91,563	4,658
U S WEST	404,647	104,763	3,863

NOTES:

(A) AT&T obtained the LECs' total number of active and retired employees from the company's Annual Report Form M for the year ended December 31, 1991. Rochester's employee data were obtained from its 1991 Annual Report, page 42, as the data filed on Form M appeared to exclude some employees. AT&T believes all employees were not included in Rochester's Form M as there may be a significant number that do not participate in Rochester's pension plan.

(B) AT&T included the total company cost before any consideration of the capital component or the rate base impact of such costs. These amounts are generally small in proportion to the total SFAS 106 liability and would not have any meaningful distortive effect on this analysis.

(C) NYNEX's low estimate, which assumes non-management health care costs are capped at the 1995 level, was included here. AT&T assumed NYNEX will adopt SFAS 106 on 1/1/93. NYNEX's $100 million interstate total SFAS 106 accrual was grossed up to a $372.3 million total company level utilizing a 26.857% interstate ratio obtained from NYNEX's 1991 ARMIS 4301 Report. Total interstate operating expenses (Column A - line 1190) were divided into total company operating expenses (Column B - line 1190) to determine this percentage.

(D) NYNEX's high estimate, which assumes non-management health care costs are projected at the full health care trend rate, was included here. AT&T assumed NYNEX will adopt SFAS 106 on 1/1/93. NYNEX's $157 million interstate total SFAS 106 accrual was grossed up to a $584.6 million total company level utilizing a 26.857% interstate ratio as outlined in (C) above.

(E) Bell Atlantic does not appear to identify its 1993 SFAS 106 total company liability; 1992 was utilized in this analysis.

(F) Rochester's (including Vista's) $4.2 million interstate total SFAS 106 accrual is grossed up to a $21.5 million total company level utilizing a 19.536% interstate ratio obtained as outlined in (C) above.

Sensitivity Analysis Performed
For AT&T
Relating to SFAS 106

July 1, 1992

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